RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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May 30, 1990 **LETTER 1044**

May 18 DJIA 2819.91; PTI 3252; A-D Ratio -10.26
May 24 DJIA 2855.55; PTI 3262; A-D Ratio -10.01
Dow Yield: 3.66%; Dow P/E: 13.5; DowPow: 390
Dow Book Value: 1075; Dow 200-day MA: 2691
Percentage of Undervalued Blue-chips: 22%
PTI 89-day Moving Average: 3256

THE MARKET: In a nutshell -- So far, the Dow hasn't wanted to go down, and a string of other indices and averages haven't wanted to confirm on the upside. Meanwhile program trading continues to jerk this market all over the board.

There are major positives and major negatives in this market (of course, there always are, but the situation today is particularly interesting). One important plus is that starting May 1 the upside breadth expanded; it expanded not only on the NYSE but on the AMEX and the NASDAQ. Here's what I look at -- each day I add the advances on all three exchanges and also the declines on all three exchanges, and I chart an advance-decline line based on the action of all three. I call it my "all-market A-D line."

This all-market A-D line recorded a low on April 30, and since then it has been heading higher. When my all-market A-D line rises, this is unquestionably a plus for the market. It means that participation is broadening.

Next, last week new highs were recorded in the Dow, the NYSE Industrials, the S&P 400 Industrials, and the NASDAQ Industrials

On May 21 it was reported that the short interest on both the NYSE and AMEX jumped to new highs, and this must be considered constructive for the market.

Finally, the bond market has strengthened considerably over the past few weeks, and a firm bond market provides a good background for stocks.

On the negative side, it is notable that this rally did not start from an over-sold base. When that happens the odds say that the rally will not be a long-lived one. Extended advances almost always begin from heavily sold-out markets, and that was not the case in late-April.

Next, there is a long list of non-confirmations. Foremost, the D-J Transportation Average has not confirmed the action of the Industrials -- has not confirmed even in a secondary sense. A complete Transport confirmation would entail the carriers moving above their own record high of 1532.01 (recorded last September 1). A secondary Transport confirmation would entail the carriers bettering their March 27, 1990, peak of 1192.57 (see page 1 chart). As this is written, even this secondary peak has not been bettered. A market that will not confirm is always a high-risk market.

The D-J Utility Average, often a bellwether, has lagged on this advance, and as you can see on the page 1 chart the Utilities are below peaks recorded in January and February.

The D-J Transports, of late, have not only refused to confirm but they have not even traveled in direction with the Dow. The Transports and the Utilities are (in my experience) the most sensitive Averages as far as economic expansions and contractions are concerned. Neither of these Averages is acting well.

Furthermore, the new record Dow high has not been confirmed by the A-D ratio, the NYSE Composite, the S&P 500, the NASDAQ Composite, the AMEX Value Index, and on and on.

Finally, it is strange that margin accounts on the NYSE have declined for five of the last six months. There is a strong correlation between the direction of margin accounts and the direction of the primary trend. Let me put is this way -- I can't remember seeing a bull market in which margin accounts on the NYSE were trending down. This may be a first, but firsts are rare on Wall Street.

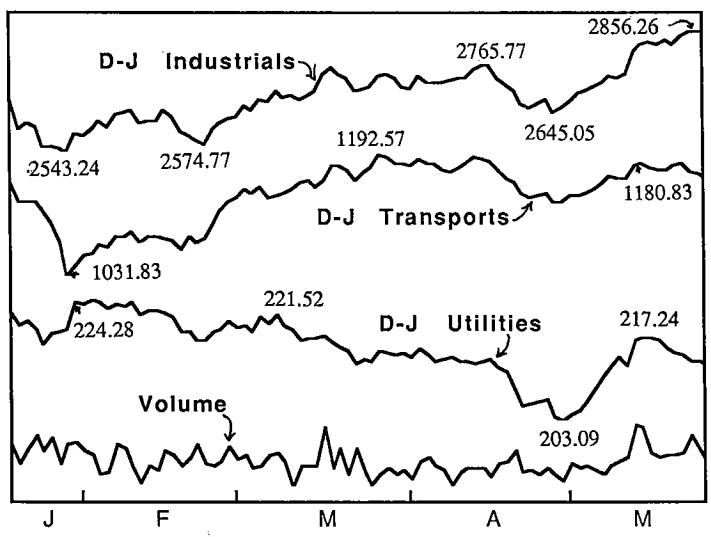
HOWEVER, there is one factor that I want to emphasize here, and that is the action of my Primary Trend Index. The PTI hit a low of 3212 on April 24 (see page 2 chart). From there the PTI has climbed quite steadily. As of May 22 the PTI was exactly one point below its 89-day moving average.

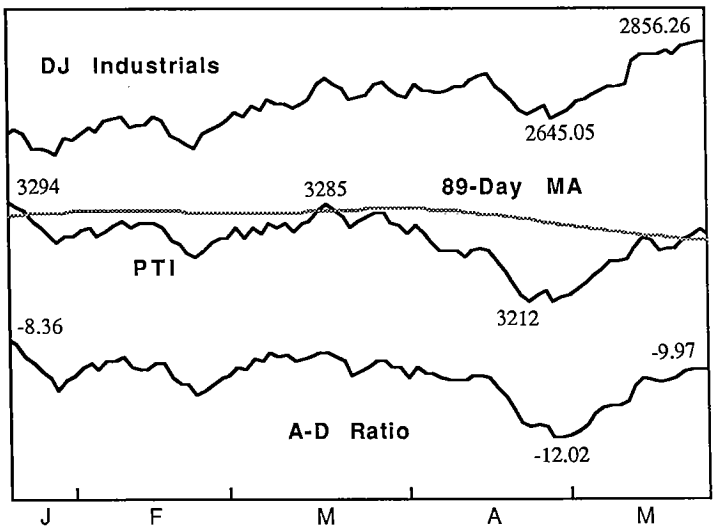
For the benefit of new subscribers, I want to provide some of the background for the PTI. Many years ago (in the 1960s) I started to worry about too many market students following the same indicators. I felt that I needed a device of my own, an exclusive device which only my subscribers and I could follow.

After a number of years of figuring, theorizing and testing, I came up with my Primary Trend Index (PTI), an amalgam of market averages and indicators. I reasoned that in a bull market there was no way that this group of indices would not go up. And in a bear market my PTI amalgam had to decline.

I've tested my PTI through 20 years of market action. It works. But like every market device ever invented, the PTI has flaws. It's main flaw is that it doesn't always lead. Sometimes the PTI acts as a coincident indicator and occasionally it even lags.

But the PTI does define the underlying trend of the market. And that's important, very important. For instance, the PTI (see page 2 chart) turned bearish in January 25, when it broke below its 89-day moving average. It has remained bearishly below its moving average, although as this is written the PTI is within a few points of its moving average.





Over the years I have learned to interpret the action of the PTI as follows: When the PTI is in a pronounced rising trend, the investment climate is positive. In other words, it is relatively easy to make money when the PTI is in a rising trend. On the other hand, when the PTI is in a declining trend, then despite what the Dow or the Transports or the high-lows or anything else may be doing, it is very hard to make money. In fact, when the PTI is in its bearish mode, the odds greatly increase that you will be showing losses in your portfolio.

The PTI has eight components. In a strong market six, seven or eight of these components will be advancing, moving the PTI up sharply. In a less-than strong market, only four or five of the PTI components will be rising. In this case (regardless of what the Dow is doing) the PTI will lag, thus raising a yellow flag or even a red flag.

In a mixed (non-confirming) market such as the one we are now in, the action of the PTI becomes particularly valuable. The January 2 high peak for the PTI was 3321. From there the PTI turned down, giving a bear signal on January 25 as it broke below its 89-day moving average. Continuing down, the PTI hit a low of 3212 on April 24. The rally since then has brought the PTI back to its moving average. For more, see Late Notes.

DEBTS, FEARS AND LIES: This piece appeared in the May 18 *New York Times*. You want to know the why of Mr. Bush's "turn about"? The reason Bush is turning around is that somebody must have let him in on the ghastly secret of what's happening to the US federal debt.

> WASHINGTON, May 17 — Why, after whistling a happy tune about the economy for 15 months and singing "no new taxes" as the anthem of his Administration, did President Bush suddenly change his tune, demand full-scale budget negotiations with Congress and imply that he was prepared to support higher taxes?
>
> **News Analysis**

Subscribers to Dow Theory Letters have known about the debt disaster for a long time, but I can tell you one thing -- it's NOT getting any better. You don't believe it? Here's an update.

The latest US Treasury figures show that the gross federal debt is now $3.092 trillion. One year ago the gross federal debt was $2.781 trillion. In other words, over the last twelve months the federal debt has ballooned a whopping $311 billion (can you see why Bush is shocked?). The US government is now running deficits at an average of $5.98 billion a WEEK or well over $1 billion every working day!

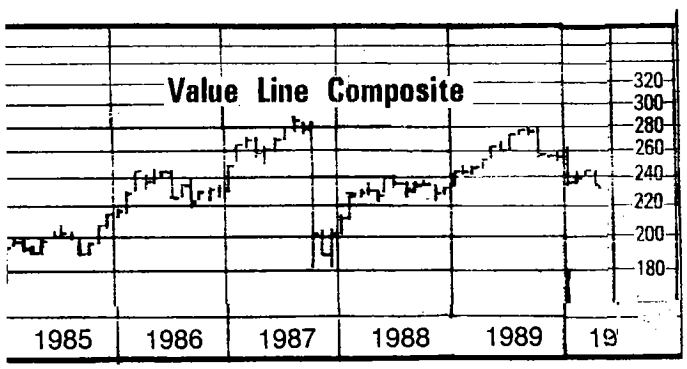
Conclusions: (1) The US federal budget it totally, unbelievably out-of-control. (2) But don't expect Washington to tell you how FAR out of control it is. (3) Don't expect interest rates to come down much. (4) Do expect Mr. Bush to give in to raising taxes. (5) Do expect the politicians to try to change the Gramm-Rudman limits. (6) The word is that anything more than $55 billion cut in federal spending will send the nation into recession. Therefore, expect a compromise with a $55 billion limit on spending cuts, plus new taxes -- plus MORE, MORE and MORE deficits to come. (6) Expect a weakening dollar on a secular basis, and I mean long-term. The new standards will be the Deutsche mark and the yen.

Also, remember this -- no matter how much Washington wiggles and waffles and lies, those $5.98 BILLION A WEEK DEFICITS MUST BE FINANCED, and they must be financed either by issuing new debt paper or by monetizing the debt. Therefore, in months to come expect an unending flood of new financing out of Washington. Also expect rising inflation (via at least partial monetization of the debt by the Fed).

The latest is that the S&L fiasco will cost the government as much as $45 billion this year. This amount will be shown as "outside the budget", but it will, of course, show in the total federal debt, which could rise by an incredible $350 billion or more in the coming year. Talk about compounding, $350 billion at 8% is an increase to the government in interest costs of $28 billion a year!

PERSPECTIVE: Every era in financial history has a theme. What is the theme of this era? As I see it, this era will go down in history as the period when the US begins to (or tries to) pay for the party.

I think that the 1987 crash will go down in history as the first crack in the "prosperity" picture. For it was during 1987 when most portfolios hit their highs, an event that is illustrated in this monthly chart of the Value Line Composite (I consider the VLC a good proxy for the average stockholder's portfolio).

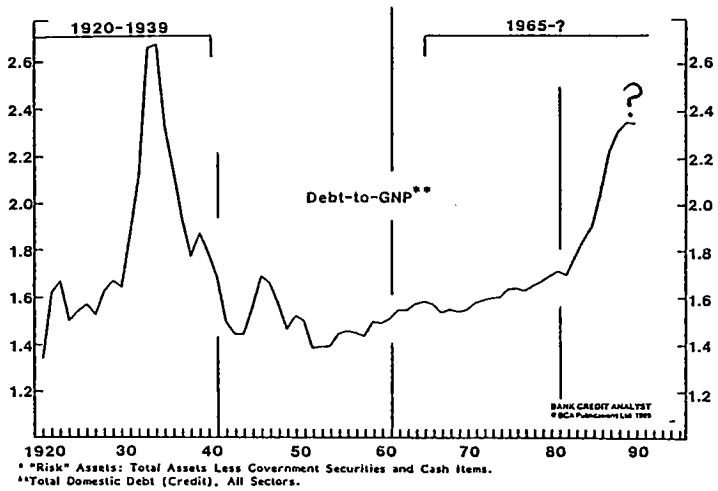


Note that the VLC touched its peak in late-1987, shortly before the crash. Following the crash the VLC rallied steadily into the fourth quarter of 1989, then turned down. At its current price the VLC is below its peak of 1986 (yes, that's 1986). Extraordinary in view of the new high in the Dow.

In his latest report Marty Zweig notes, "Since the September 1, 1989 peak, the Dow is now ahead 11.0%, but the typical Big Board stock is down 11.4%, while the Amex is off 14.2%. . . . In the US only 1929 and perhaps 1972 and 1987 can rival the recent pattern of negative divergences."

This chart (courtesy of the *Bank Credit Analyst*) tells an important story. Here you see the total domestic debt from all sectors as a ratio of the Gross National Product (GNP). The last major peak in this ratio occurred in 1933-34, and the run-off or collapse in the ratio lasted until the early 1950s.

Now the ratio is at another peak, and the question is -- whether the run-off in debt (a decline in the ratio) has begun. You have to wonder because of the collapse in the S&Ls, the collapse in the market price of bank stocks, and the current reluctance of the banks (following their mountain of bad loans) to make additional loans. Bank failures are now the highest in history, as are personal



* "Risk" Assets: Total Assets Less Government Securities and Cash Items.
**Total Domestic Debt (Credit), All Sectors.

bankruptcies, and at the same time the rate of debt creation has broken a rising trendline that extends back to the 1950s.

At this point the name of the game in Washington is, "Don't blame me if taxes are raised." As the boys in Washington meet to try to deal with an above-$200 billion federal deficit, it is believed that the Administration would like to make a deal with Congress and the Fed. The deal would be that the politicians (from maybe both parties, no one knows for sure) would allow taxes to be raised and the deficit to be dented in return for a lowering of interest rates on the part of the Fed. That kind of a trade-off would probably lead to increased inflation, but with an election coming up, our gutless politicians in Washington would be more than willing to allow inflation to heat up -- at least for a while -- if they could only be reelected.

Comments: The Blue Chip Economic Indicators survey of 48 top business economists reports that two-thirds of its member now believe that a recession will not start until 1991 at the earliest. Can two-thirds of these economists be right? It would surprise me.

I just received the latest *Wellington Letter,* written by my Friend Burt Dohmen [(808)396-2220]. Burt has been in this business a long time and is an excellent market student. He writes: "In my opinion, we are now in recession. It won't be generally recognized until later this year. . . Unfortunately, economists have short memories. Inflation usually rises throughout the first 75% of the recession. It is a lagging indicator. Remember the deep 1974 recession? Economists did not declare it a recession until March of 1975. By that time many stock groups had declined 80-90%, the Dow had declined 44% and many firms had gone bankrupt. In other words, they didn't recognize the recession until it had been in progress for about 18 months. Similarly, the current recession has not been recognized." Words worth remembering.

At this point you have to remember that with the deficits this severe and with many segments of business turning down, the Administration and Washington in general are frantic to avoid recession -- or even the hint of recession. Thus, a lot of propaganda is coming out of Washington -- aimed at giving the impression that "all is well" and if it isn't "it will be handled one way or the other."

A recession at this stage of the game would mean collapsing tax receipt to the government and federal deficits spinning into the wild blue yonder (they are doing that anyway). Frankly, I have never seen such subterfuge, confusion and bunkum coming out of Washington. Meanwhile, I guess every humorist and cartoonist in the nation has done something with Bush's "Read my lips" statement. That statement got him elected, but it's coming back to haunt him now.

INVESTMENT POSITION: With numerous nonconfirmations, with the Dow selling at a whopping 2.6 times book value, with the broad S&P 500 yielding only 3.4%, I consider this a high risk market. It may not be ready to fall apart -- but it is high risk. I work hard for my money, and I don't like high risk markets. I also don't like a market (such as this one) that rallies off a semi-oversold base. I'm always tempted to buy when a market becomes thoroughly oversold. That just wasn't the case at the late-April lows.

Personally, I've opted to remain in 91-day T-bills. When the bills come due I simply "roll them over." The bills are staying pretty much in the 8% yield zone, which is fine with me.

The bear stays in the box.

MODERN INVESTING: What's happening to technical analysis? My own feeling is that it's becoming **too popular,** and the more popular it becomes the less useful and reliable it becomes. When I started this business in 1958 technical analysis was literally unknown, and where it was known it was despised. Bank and brokerage departments frowned on technical analysis, only a tiny handful of market letters dealt with it, and most stock market analysts were openly against it.

Today we have come full circle. There are market technician societies in major cities, almost all advisory publications deal with technical analysis in one form or another, newspapers talk about advance-decline lines and non-confirmations. New computer programs almost daily boast of programs geared to various facets of trading based on technical analysis. To put it briefly, technical analysis in my mind has become far too popular and far too accepted.

What is the result of all this popularity and all these technical practitioners? My feeling is the market has turned increasingly "nasty" and "resentful." Remember, the markets are not "rich uncles" bestowing their largesse on the happy players. Hardly. The markets are Wall Streets counterparts to the "mean streets", and the gods of the markets like nothing better than to separate the players from their bankrolls. Consequently, the markets have become a jungle and jumble of whipsaws, jiggles, sudden swoons and equally sudden explosions.

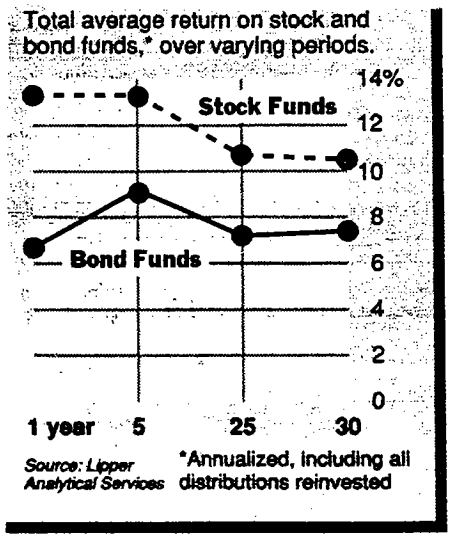
Due to the rising acceptance and popularity of technical analysis, I have learned to increasingly distrust techniques and methods that I have relied on for years.

In view of all this, what is today's investor to do? My own instincts veer to two areas: (1) Diversification, and (2) Dollar averaging.

I believe it is harder than ever today to beat the trend. Therefore, in my own personal investing I have moved to both diversification and accumulation and I mean the accumulation of values.

There are a few facts that the investor should fix firmly in mind. The first is that for over half a century the average total return to stockholders on equities has been slightly better than 10%. To me that means that any time Treasury bonds come anywhere near the 10% yield zone, stocks are in danger of being overvalued compared with T-bonds. The logic is obvious -- why hold stocks when T-bonds give you a safe 10% yield, the same yield stocks give you over an extended period of time?

The second thought is this: This chart shows the total return on both stock funds and bond funds over various periods of time. Note that over a 30 year period the total return on stocks was



slightly above 10%. But at present (see one-year dot on the chart) the total return on stocks is roughly 30% higher than the 30-year average.

What does this tell us? It tells us that stockholders got used to the juicy returns of the 1980s, but somewhere along the line (probably beginning soon) the pressure will arise to bring the total return down towards the norm, the norm being a total return a bit over 10%. To bring the current total return down to the long-term norm, the markets will have to decline. To be more specific, the markets will have to decline over 30% to bring current total returns down to the historic norm.

In my opinion, this concept is the "Sword of Damocles" that is hanging over equities today.

So again, what do we do? My own instinct is as follows. (1) Continue to accumulate bullion coins at a monthly fixed-dollar rate. (2) Use the T-bill market as the main basis of your investment program, at least for the present. Extremely safe yields of around 8% (free of state taxes) are a good deal, at least while we are waiting to see which way the wind blows. (3) Think in terms of compounding. (4) Don't count on rising home prices from here to increase your net worth. The "annual guaranteed advance" in the price of homes may be over. (5) Think in terms of getting out of personal debt. It's hard to build assets if you're in debt unless you have inflation behind you.

NOTES & QUOTES: I just received a Letter out of Canada from Jack Frost, Elliott Wave expert (he co-authored "The Elliott Wave Theory" volume with Bob Prechter. Says Frost, "Recent developments from Feb. 23, 1990, to April 30, have extended the ABC wave to an ABCDE wave, thereby strengthening the Elliott picture. We project 3249 DJIA -- then the deluge." . . . Meanwhile my old friend, Joe Granville, remains bearish, using his new "Theory of Opposites." Time will tell.

* *

Global money management is becoming a major industry, and if you want to know what's going on you literally have to track the major currencies (pound, yen, Swiss franc, Deutsche marks, dollar). The May 19 issue of *The Economist* makes an interesting statement: "Why so little talk about the dollar these days? The most intriguing development in currency markets these days is that the dollar is no longer the driving force: it is the yen and the D-mark that are calling the moves."

* *

Speaking of the dollar, the S&L bailout is going from bad to being an absolute horror. The minimum cost of the bailout over the next 40 years will be $325 billion, and other estimates (assuming higher interest rates) rise to $500 billion. Each month of delay is costing the government $2 billion additional. I actually overheard this comment, which I guess I'm labeling the most pathetic question of the week: "Why should we taxpayers pay for the bailout -- why not let the government pay?"

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Some of the governmental agencies are so thinly capitalized that if it were not for federal backing, their bonds would be considered in the "junk" class. Fannie Mae has $3 billion of equity supporting $336 billion of mortgages. Freddie Mac has $1.9 billion in equity supporting $294 billion in mortgages.

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Commodity Information Systems (P.O. Box 690652, Houston, TX 77269) is an excellent commodity advisory. Here's what they are saying, and it's well worth listening to: "We have been bullish on agricultural commodities for a long time. . . Livestock and grain markets have begun to advance and few traders realize what is happening . . . Some government leaders are becoming concerned that food surpluses are gone . . . Many industry leaders are worried that prices are rising and they have no forward commitments. . . I believe we owe it to our loyal subscribers to 'sound the alarm' on what we believe is the beginning of historic bull markets in food commodities. If what I believe is about to happen --happens . . it will make some of our subscribers wealthy . . .it will be a challenge we have prepared many years for . . It will be an historic occasion we will tell our grandchildren about." Russell comment: If this is true, it will be inflationary. Watch gold, watch the CRB Futures Index.

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A few years ago the state of California was all a tizzy about what to do with their $1 billion budget deficit. Those days are gone. This year the Golden State is running a shocking $3.6 billion deficit, and Deukmejian promises no new taxes. What then -- a massive cut in services, what else. This is the fourth year in a row officials here have been wrong on revenue, and we're not even in "recession" yet.

* *

The May issue of *The Market Technician's Newsletter* includes an excellent article by Marty Zweig. Marty warns readers not to become enamored with any single market study, and he notes that studies that have worked for decades can malfunction. Marty also documents the fact that insider buying can be totally misdirected (which reminds me that Dow Theorist Wm. Hamilton wrote, "Enough inside information will break any man on Wall Street."). Marty includes a chart showing that since 1974 areas of heavy insider buying have been associated with poor markets while areas in which insiders were dumping stocks in their own companies were all too frequently market bottoms. Conclusion: Despite what you have been led to believe, insiders act much like odd-lotters, buying and selling at just the wrong times.

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Efforts to limit world population growth are failing. The United Nations Fund for Populator Activities says that in this decade we will see the greatest growth in population in history. By the year 2000 the world population will go up over one billion, equal to a new nation the size of China. Thus the year 2,000 will see a world count of 6.25 billion -- and building.

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In view of the above described explosion, we might ask, "Where's the good life?" This is a fascinating rundown, courtesy of *The International Monetary Fund Survey:*

	Automobiles per 1,000	Telephones per 1,000	TVs per 1,000	Daily Calories per Capita	Population per Physician	Infant Mortality (per 1,000 live births)
Bulgaria	120	200	96	3,642	280	15
Czechoslovakia	173	226	122	3,448	280	13
German Democratic Rep.	209	211	119	3,814	440	9
Hungary	145	134	275	3,569	310	17
Poland	105	118	85	3,336	490	18
Romania	11	130	. . .	3,373	570	25
Yugoslavia	125	122	175	3,563	550	25
U.S.S.R.	42	115	300	3,399	480	25
Germany, Fed. Rep. of	446	641	377	3,528	380	8
Japan	235	535	250	2,864	660	6
United States	572	650	621	3,645	470	10
Argentina	127	100	213	3,210	370	32
Brazil	76	90	184	2,656	1,080	63
Mexico	65	90	108	3,132	1,240	47
Korea, Rep. of	16	294	. . .	2,907	1,170	25
Malaysia	84	. . .	. . .	2,730	1,930	24
Taiwan Province of China	54	277	104	3,050	850	. . .
Greece	127	373	158	3,688	350	13
Ireland	206	235	181	3,632	680	7
Spain	252	381	256	3,359	320	10

* *

The price of colored gems (i.e., emeralds, rubies, sapphires) is booming, and the upside action now appears to be eclipsing the price action of diamonds. But the real activity isn't in the US, as this notation from the May 4 *Rapaport Diamond Report* indicates: "Our economy is not a factor in these gem sales," said a New York gem dealer. "The market today is in Europe, the Orient and other places. The best buys are in America . . . people are buying in America and selling in Europe."

Confirming the above is Tiffany's (jewelry) latest report, showing that international retail sales in the fourth quarter rose 115% while their domestic retail revenue actually declined.

* *

The 1990-91 budget circus is beginning, and some have named it "The Nightmare on Pennsylvania Avenue." The Democrat-Republican get-together is being driven by two fears -- (1) Fear of massive Gramm-Rudman across-the-board cuts, (2) Fear that one's party will be blamed for the coming higher taxes. The problem is that the real federal deficit will be above $250 billion, but even the phoney deficit (which includes the Social Security surplus) will be above $100 billion. Cutting $100 billion out of the budget would set off a recession, so you know that a compromise is the very best that will come out of the current "onslaught" on the budget.

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Wags have it that when Bush said, "No new taxes," what he was really doing was speaking for endangered animal species. What he meant was no new taxes on imported antelopes or gnus, thus, "No gnu taxes." Another theory is that Bush actually said, "No new Texas," meaning, in view of the historic annexation of that part of Mexico and with the great number of Hispanics now coming to the US, he did not want another state -- thus "No new Texas."

* *

What do you do in Washington when someone insists on telling the truth? Seidman (former head of the FDIC) repeatedly told the world that the S&L bailout would be far above the Administrations estimates. That was too much for George Bush, and Seidman (probably one of the most qualified men) was sent packing.

* *

Why do newspaper insist on not providing complete futures reports on one page? Grrr. The *Wall Street Journal* drives me nuts by spreading the futures all over the place. The *New York Times* and most newspapers omit the opening futures prices. Only *Investor's Daily* and the *Los Angeles Times* put the whole story with open, high, low and close on one page. For years I've complained that the archaic *WSJ* has screwed up by not providing proper material for real market followers. They still don't, and I think it's one reason why they're losing circulation.

* *

America's Cup, the international boat race, will be held in San Diego waters in 1992. The Japanese have no history of nautical success or prowess, but they are going all out to win the next Cup. Thirty major Japanese corporations are putting up hard cash (they may go as high as $100 million) to sponsor a team and the ultimate in high-tech ship sailing. No expense will be spared by the Japanese to win America's Cup.

* *

Speaking of Japan, the *USA-Japan Letter* (P.O. Box 9102, Framingham, Massachusetts 01701) writes about "Japan's entrenched big industrialist Power-Barons" and states that "The sum of all this is that the Power-Barons who run Japan remain committed to their goal of economic domination of the World. Their financial base has shrunk. To resume its growth, they need to revise their strategies. This revision is well under way -- and the new Germany is now one focus of it. That does not mean any weakening of their determination to control the American economy. They are, however, changing their modes of attack, to less prominent ones that will not attract media attention or cause more Japan-bashing in Congress. The big spectacular buyouts such as the ones last year of Columbia Pictures and Rockefeller Center, which aroused a wave of anti-Japanese feeling in the American public, are being avoided. Most of the Japanese investments here are now going into buying small companies and real estate. Russell comment: I have never subscribed to any of the various "conspiracy" theories, but I do think there is a lot of truth in the above, and I have no doubt that certain powerful Japanese industrialists have dreams of controlling the world's economy.

* *

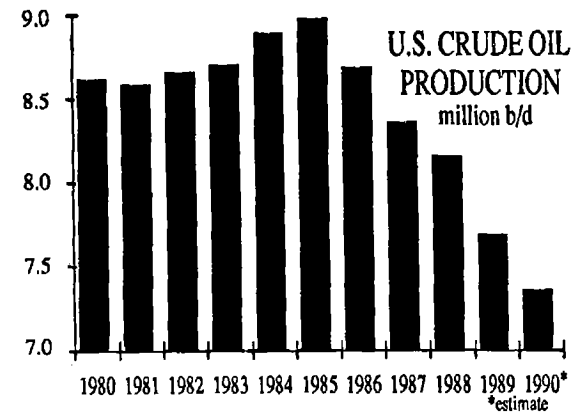
The Russkies are coming. In July the Moscow Bears (part of a 24-team league in the Soviet Union) will come to play Minor League Football System teams in five US cities. The Bears will be coached by ex-Denver Bronco coach John Ralston. The games will be played in Tacoma, Fresno, Oklahoma City, Macon and Charlotte. Gad, international football is on the way.

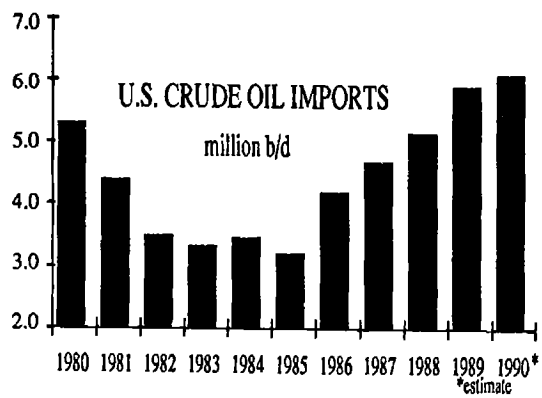
* *

The world auto competition keeps heating up. Chrysler's Lee Iacocca hawks the superiority of his cars over Honda's in a series of commercials. But for the first four months of 1990 Chrysler's US sales are off 21% against an industry-wide drop of 4%. Meanwhile, Ford is upping its incentive bill (rebates) from last year's $2 billion to $4 billion for 1990 (that's billion, not million).

* *

This chart from *Myers' Finance and Energy* (N. 7307 Division, Spokane, WA 99208) tells an ominous story. Oil imports to the US are on a steady rise while US production continues to drop. Says Myers, "The overriding problem is that the US is running out of oil. The US produces only 4% of the total world's output, but accounts for nearly 30% of total world consumption . . .Consider this: the US holds only a tiny percentage of the world's reserves, but has drilled four times as many wells as the rest of the world combined. The topography of the southern US looks like a pincushion." Russell comment: There's going to be an oil crisis before the 1990s are out. OPEC reserves continue to rise while US reserves decline. By the year 2,000 the US will be very dependent on Arab oil, and I mean VERY.





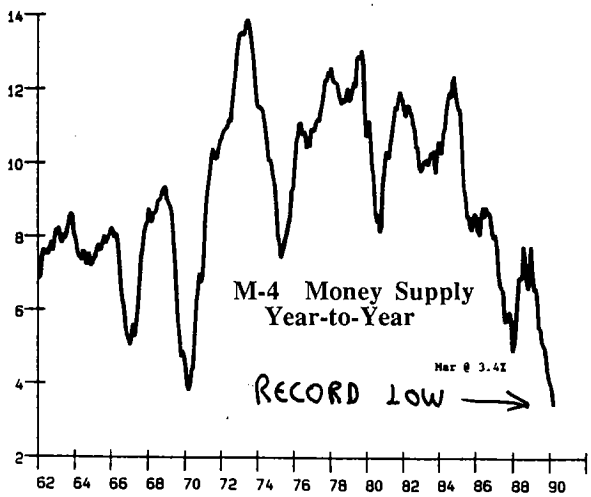
GOLD: Here's an interesting thought: Last year in 1989 South Africa produced a total of 606 tons of gold. At 375 dollars an ounce, that's equal to $7.2 billion worth of gold. That $7.2 billion of gold is roughly equal to seven days of US government deficits. All the gold produced in the world this year wouldn't equal three weeks of US federal deficits. And the gold/debt ratio continues to build, day after day, week after week.

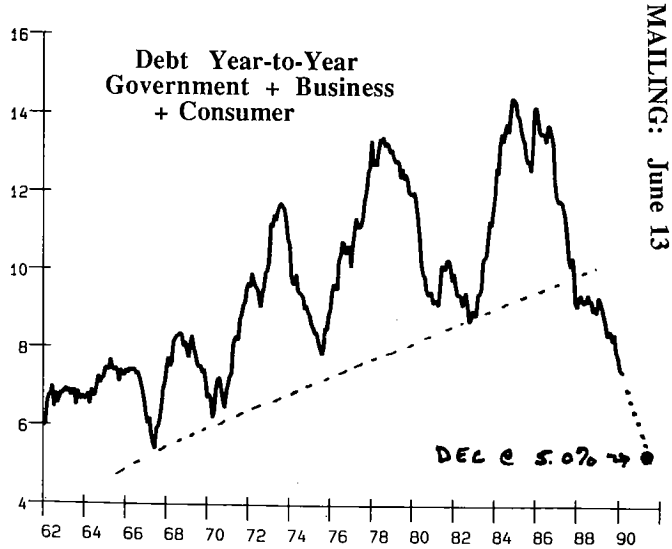
But gold is having its troubles, strange troubles. On May 18 June gold finally closed over 375 for a minor upside breakout. On the

basis of the breakout, many gold followers turned bullish. But on May 23, as if on command, gold was knocked down to the tune of 12 dollars, taking the June contract down to a morning low of 361 -- although the contract closed at 365.50 and opened next day at 367.40. The rumor again was that it was Arabian dumping that knocked gold down. Since the Arabs are known to be experienced and shrewd gold traders, it certainly makes one wonder if there isn't some sort of a secret deal on, a deal to make gold look bad.

Well, it's a mystery, but on the face of it sinking gold along with sliding oil certainly looks deflationary. The deflationary aspect seems to be confirmed by this chart of the very broad M-4 money supply which on a year to year comparison is now growing at the lowest rate in history (money supply and debt charts courtesy of Ed Hyman of *C.J. Lawrence*).

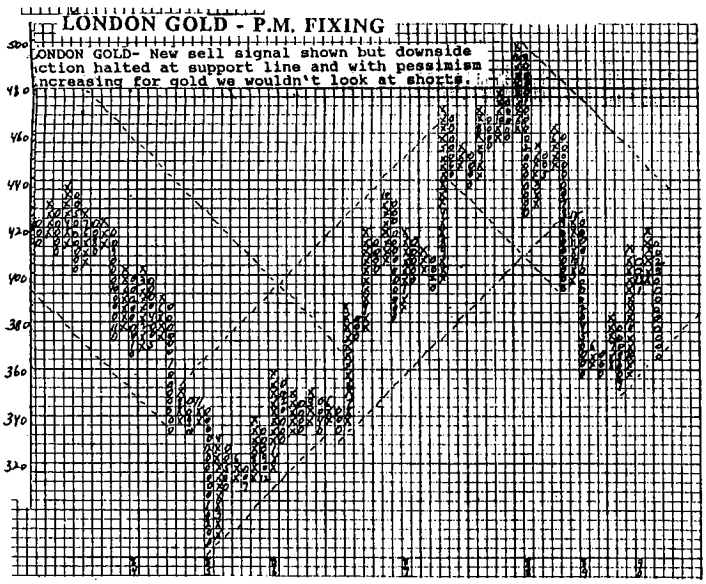
A collapsing rate of money creation and a continuing drop in debt creation would also seem to guarantee recession. And recession should be accompanied by deflation. If recession becomes official, I would expect the Fed to open the monetary spigots wide, at which time gold would take off and the dollar would swoon.





NEXT MAILING: June 13

The accompanying point & figure (PM gold fix only) is particularly interesting at this time The reason I find it interesting is that on May 23, during the second big Arab "bombing" of gold, the London PM fix was 364.50. That figure failed to alter the chart. A PM fix of 360 would have been required to do that. It may not mean much, but I did think it was fascinating that with all that downside action the gold price structure as seen on this chart held intact. "Little things" like this often loom important in retrospect (P&F chart courtesy of *Chartcraft*, Larchmont, NY).



LATE NOTES: From headlines late last week -- "Defense Industry Shrinks, Suppliers Face Widely Varying Fates." "Air Fare War Heating Up." "Sales of US-Built Vehicles Fell 17.7% in Mid-May, Auto Markets Stay Weak." "Durable Goods Order for April Fell 4.1%." "Cost of S&L Bailout Could Double." "Real Estate Prices Continue Weak." Russell comment: Friends in all industries from jewelry to textiles to housing tell me, "It's slow." Don't tell anyone, but I think the nation is in recession now.

Price action: I can't prove it, but it does seem as if no matter what the Dow is doing during the day, someone or somebody (program trading?) boosts the Dow to the plus side during the last ten or fifteen minutes. It's almost predictable. However, the Transportation and Utility Averages haven't been in this "last half-hour act," and they're both getting further and further out-of-gear (diverging) on the downside -- and that's dangerous.

The Transportation Average has now traced out a downward zig-zag -- a definite sign of weakness. Continued divergence between the Dow and the Transports creates a technical tension. It's like a spring being stretched. Ultimately, either the Transports will join the Dow to the upside or the Dow will top out.

The collapse of crude oil to the 18 area "should have been" a big help to the Transportation Average, since one of the carriers' major expenses is fuel (of course, oil around 18 is hardly a help to our Southwestern oil-producing states).

Here again is my "directional chart" of the Dow, a P&F chart based simply on whether the Dow was up or down for each trading day. This has been the most persistently bullish chart around. When this index goes into a definitive downtrend, it will tell us that the strongest segment of the market, the Dow, has finally turned bearish.

How about the action of the **PTI**? On May 23 and 24 the PTI pushed slightly above its 89-day MA, but not far enough above it for me to call for a bullish reversal of trend. As this is written, however, the PTI has slipped, and it is now literally sitting on its moving average. However, the moving average is declining, and it is well to remember that the definitive bullish mode occurs when the PTI is above its MA and the MA is rising.